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100 Percent Exclusion for Qualified Small Business Stock Finally Made Permanent

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Among the many "tax extenders" in the Protecting Americans from Tax Hikes Act of 2015 (PATH Act, Division Q of the Consolidated Appropriations Act, 2016, P.L. 114-113, enacted December 18, 2015) is a permanent extension of the 100 percent exclusion from gross income for certain gains from the disposition of "qualified small business stock" (QSBS) held for more than five years.

- Section 1202 of the Internal Revenue Code was enacted in 1993 to encourage investment in small businesses. Subject to certain dollar limitations, it originally provided that 50 percent of the gain from the sale of QSBS held for more than five years was excluded from a taxpayer's gross income. The reduction in capital gains rates following enactment of section 1202, a rate of 28 percent on the non-excluded gain and inclusion of a portion of the excluded gain as an item of tax preference under the alternative minimum tax (AMT) eroded the benefits of the exclusion.

- In 2010, and subject to the same dollar limitations, section 1202 was amended to increase to 100 percent the amount of gain from the sale of QSBS held for more than five years eligible for the exclusion, and also eliminated treatment of any portion of the excluded gain as an item of tax preference under the AMT. This change was originally applicable to QSBS acquired after September 27, 2010 and before January 1, 2012, but was later extended to apply to QSBS acquired in 2012, 2013 and 2014.

- Prior to the PATH Act, the section 1202 exclusion percentage for QSBS acquired after December 31, 2014 had reverted to 50 percent and the AMT tax preference item had been reinstated. However, the PATH Act makes permanent the 100 percent exclusion and AMT preference elimination, retroactive to QSBS acquired after December 31, 2014.

- The amount of the exclusion continues to be limited to the greater of (i) $10 million per taxpayer per issuer (reduced by any gain excluded in prior taxable years on the sale of QSBS of the same corporation) or (ii) 10 times the basis of any QSBS of the same corporation sold during the taxable year (determined without regard to any basis additions occurring after the date on which the QSBS was originally issued).

- All other provisions of section 1202 remain unchanged, including the definitions of QSBS and "qualified small business" and the limitations on excludable amounts. For more information regarding the definitions, eligibility requirements and limitations of section 1202, please see our September 1998 Tax Bulletin, *Qualified Small Business Stock Update*, and our February 2013 Tax Bulletin, *Qualified Small Business Stock Developments*.

Available Material

- Consolidated Appropriations Act, 2016, H.R. 2029, P.L. 114-113, as signed by the President on December 18, 2015.

- Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40), Joint Committee on Taxation, JCX-144-15, December 17, 2015.

The information presented is only of a general nature, intended simply as background material, is current only as of its indicated date, omits many details and special rules, and accordingly cannot be regarded as legal or tax advice.

If you have any questions about the content of this alert, please contact one of the authors, the Pillsbury attorney with whom you regularly work, or one of the attorneys below.

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